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THOMAS S. VIRSIK

MEMORANDUM – draft

May 9, 2003

Re: Allocation of proceeds of any transfer of water – water right
Memorandum of IID, undated, seven pages, distributed on April 30, 2003

Background: IID provided feedback to the memo of March 27, 2003, for which we are thankful. IID's positions help to identify what parts of the Imperial Group memo may have been misunderstood or perhaps taken out of context so that those misimpressions may be corrected. The IID memo also helps to illustrate that while IID pays lip service to its trust responsibilities, it does not apply them – not even in its memorandum. Unfortunately, the IID memo does not appear well supported and may be more of a PR statement for the benefit of the individual directors rather than a thorough exploration of the law. Nevertheless, IID's memo confirms that there is agreement on a number of important issues.

Even if phrased slightly differently, IID and the Imperial Group agree on a number of important issues, which form the basis of all of the positions taken by the Imperial Group. Following the points of agreement, we will try to illustrate the remaining apparent differences and how the IID positions differ from the Imperial Group's only because IID has –whether inadvertently or purposely – failed to test all of its positions against its trust responsibilities to the lands (landowners) despite specific notice to the IID in November 2002 that an irrigation district was subject to California trust law. Allen v. Hussey (1951) 101 Cal.App.2d 457, 468 and 474 (finding irrigation district transaction void ab initio under California trust law even when third party and trustees acted in good faith on advice of counsel). Moreover, each individual Board member is in effect responsible for the actions of his or her fellow members. Probate Code § 16013 (co trustee obligated to prevent a co trustee's breach of duty or to redress breach by another if it occurs).

Issues on which the Imperial Group and IID agree:

- IID holds the water rights of the Imperial Valley in trust for the landowners, i.e., not residents or the public in general. (Bottom of page 1 of IID memo). The politics complicate – but do not change -- this reality, as several Directors recently admitted at the May 5, 2003 IID board meeting.

- An irrigation district is authorized to apportion or allocate water to district lands. (Page 2 of IID memo).

- Individual landowners may not transfer water out of district boundaries, whether or not that water is apportioned. (Question 5, pages 3-5 of IID memo).

Issues of apparent disagreement:

Application of Water Code section 22262. IID takes the view that the landowners could not have developed their own water rights against the district because the Water Code prevents anyone from

perfecting rights against an irrigation district. Water Code § 22262, ("No right in any water or water right owned by the district shall be acquired by use permitted under this article."). To grasp what the section really means, one must understand that under California law there are ways in which someone can take (appropriate is the technical term) water over a long enough period of time from a watercourse until that taking becomes a right. IID is correct that the Water Code prevents strangers from acquiring rights by using district water. Ivanhoe Irr. Dist. V. All Persons (1957) 47 Cal.2d 597, reversed on other grounds 357 US 275; Jenison v. Redfield (1906) 149 Cal. 500 (landowner's use of district water outside of district under a claim of right created no right). For example, if MWD dug a pipeline under the sand and started sucking water from the canals, it could never develop a right by its actions, no matter how long they occurred or how public it was.

But to apply that section against a beneficiary who has a right to the water in the first place is, frankly, odd. We cannot find any authority that the legislature had that sort of result in mind. All the code section means is that individual landowners cannot develop water rights in an irrigation district separate from the rights the irrigation district holds in trust. On the other hand, the section may be applied to prevent individual beneficiaries from claiming that they have through long-term use acquired a historical right to a specific amount of water. In other words, if Landowner A used 10 acre-feet per acre for 20 years, that would give him no right to continue to use that same 10 acre-feet in year 21. He cannot develop a right through use. His right is instead proportional, which number (not proportion) may change from time to time. That analysis, for example, supports allocation on a straight-line method rather than a historical one.

Allocation and/or apportionment. IID mischaracterizes the Imperial Group memo. The Water Code is clear that sections 22250 and 22251 provide one of several methods by which to divide water in an irrigation district. There are other methods available under that "article" of the Water Code, as IID states. (Middle of page 2). Those other methods, however, do not seem either useful or available under the present circumstances, which is why the Imperial Group memo concluded that the use of section 22250 was the most likely result (which IID's current plan also includes). In the order of the Water Code, the other provisions set out in that article are as follow:

- treat people paying for water equitably (section 22252), a section about making charges fair, not about how to divide water
- a unanimous board may develop deliveries based on crops in time of shortage and other crises (sections 22252.1, 22252.2, and 22252.3), not applicable since board has not acted and there is no shortage
- deliveries to mutual water companies (sections 22253, 2254), not applicable to Ag. lands
- deliveries to district lands held by collector's deed (22256), not applicable
- rules regulating deliveries, such as standards for canals and pipes (22257), does not address right to water, just regulation of facilities
- deliveries outside of district (22258), not applicable
- surplus water use (22259), not applicable
- sale of water rights prohibited (22261), self explanatory
- acquisition of rights against district (22262), see above
- cannot harm by diversions (22263), not applicable
- health and safety issues of non-ag uses (22264)

Thus, the memo provided to the Imperial Group concluded that of all of the options permitted, sections 22250 and 22251 were the most likely to be of use at the present time. IID's own proposal for allocation tellingly agrees, at least in part.

Trust standards affect allocation system. Could IID create a new assessment system and then apportion water based on those values? Yes. Must it? No. Is it in the beneficiaries' interest to take months to reassess land, potentially leaving the water management unresolved in this critical

year involved in the federal Part 417 review? No, and under the prudent person standard of trust law, IID must choose the method that is the most beneficial to its beneficiaries, rather than what is politically expedient. Probate Code § 16040 (trustee standards). That is why the memo to the Imperial Group concluded that a one-for-one assessment is the only realistic option at this moment – considering both the limitations of the Water Code and the overarching trust standards.

In our view, assessment for water allocation is straightforward. The improvements are not assessed. Water Code § 25501. The value of the land for purposes other than to produce crops is not relevant. Canals and works are not relevant. Id. Thus, all that remains is the suitability of the land for agriculture. While some land is better than others for some crops, there is no reason to speculate on values in an ever-changing economy and with the wide variation of farmers and farming practices. For example, one farmer may through skill and luck earn more off of so-called marginal land with so-called "low value" crops than another with so-called prime land. Developing a system to take all this into account could be complex, and complexity is not in the beneficiaries' interest. The overriding goals are to create a method that is simple, quick, reliable, and transparent – all standards IID also states as its goals. The proposal of May 5, 2003 released by IID tries to take into account some of these countervailing concerns, and ends up complex. That is why a one-for-one assessment is the best option for IID given the present pressures. The question to be answered is not simply "what options are available under the Water Code" but rather "of the options available, which is the most consistent with IID's trust responsibilities given the present situation?" A one for one assessment is the most consistent with present concerns.

IID ignores substantive and procedural trust restrictions. Under standard trust law, a trustee cannot pick and choose favorites. It must treat all beneficiaries impartially. Probate Code § 16003. IID relies on section 1011 (and others) of the Water Code to claim that it need not treat its beneficiaries impartially, but may contract with individual landowners to create "conserved" water to sell out of the district to third parties. (Point 6, page 5 et seq. of IID memo.) Presumably IID gets a cut of the action, i.e., retains some funds for its discretionary use. As stated in our prior April 27, 2003 draft memo, traditional irrigation district law holds that if one water user uses less, her neighbors are entitled to use a proportionately higher amount. Page 4 of April 27, 2003 DRAFT memo. The IID is of the view that the SWRCB decision has changed all that and "conserved water" can be transferred out of district boundaries for payment – if and when the IID board says so.

Assuming for the moment that IID is correct in its interpretation of the half-dozen or so Water Code sections that underpin the SWRCB decision, can those Water Code sections really alter the trust relationship between IID and its beneficiaries? We think not, for several reasons. First, those sections are not part of the Irrigation District Act and if the legislature wanted to make a change to the specific trust relationship upon which irrigation districts are based, it would have altered the provision that mandates the relationship. Water Code § 22437. It could have changed that section to say "The title to all property acquired by a district is held in trust for its uses and benefits except for the creation of conserved water, which conserved water shall be allocated proportionately to the lands that created the conserved water." But it did not. IID's theory, when stripped of its Water Code minutiae, is that the SWRCB decision created a second and different class of trust assets called "conserved water" that is to be administered differently that all other trust assets.

The overriding point is that IID interprets the SWRCB decision (and other documents and/or laws) to create a change in the trust relationship – a change that gives the IID more authority and discretion. If IID intended to truly make such a change when it started the approval process in 1998, it was obligated to provide written notice of the changes it sought so that the landowners could have exercised their rights, whether at the SWRCB or in a Court. Probate Code § 15404 (change of trust by Court action with agreement of beneficiaries). IID asserts it has discretion. And assuming it does, it is nevertheless obligated by law to exercise that discretion for the beneficiaries' benefit, and not (1) to benefit a third party such as San Diego or (2) for political expedience. Probate Code §§ 16080 and 16081 (trustee cannot exercise discretion in disregard of

purpose of trust). That IID takes the view that the trust is irrevocable only makes matters more serious, for irrevocable trusts cannot be modified without the agreement of all beneficiaries. Probate Code § 15403. To date, IID has not even mailed to its beneficiaries an explanation telling them that the IID board wants to create a separate class of trust property that would be allocated to each landowner separately in derogation of the traditional "communal pool" concept of an irrigation district. Probate Code § 16060 (duty to keep beneficiaries informed).

Perhaps it is in the interest of the beneficiaries to create a separate class of trust property in the conserved water. But that choice is for the beneficiaries, not the IID. There are methods available to IID to make the change to the trust relationship it wants, such as fling a lawsuit in the local Superior Court interpreting its trust and asking that the Court allow it to make the changes. Probate Code § 15409 (trustee may petition for Court modification in changed circumstances) or § 15412 (trustee can ask Court to divide single trust into separate trusts for beneficiaries, i.e., to create separate trusts for each landowners' water conservation assets), see also Water Code § 22650 (Board has authority to initiate suits to carry out its purposes). If IID desires to treat conserved water differently than all other trust assets, it must first obtain a change in its trust instrument, which process (judicial or legislative) it has not yet started.

Individual landowners transferring water outside of the District cannot be paid to conserve. The IID is firm in its position that individual landowners cannot transfer water outside of the district boundaries for payment. How can IID then reach its conclusion that the IID can contract with the same landowners to transfer water outside of the district boundaries for payment? (Point 6, bottom of page 5 of IID memo). IID answers that the SWRCB approved this anomaly, and recites an entire page of Water Code sections (without explanation) in support. (Page 6 of IID memo).

Has the SWRCB really wiped away all of IID's trust responsibilities? Has it authorized the IID to ignore its trust responsibility to treat its beneficiaries fairly? Has it changed the Irrigation District Act? Has that decision changed the standards expected of IID and all trustees? Probate Code §§ 16040 (standard of care), 16002 (duty of loyalty) and 16005 (if trustee becomes trustee of adverse trust, he must resign). In a word, no.

The SWRCB decision relied on a number of interpretations of and changes to various laws, but no change to or interpretation was made of IID's organic authority, the Irrigation District Act (except environmental provisions under SB 482). Just because the SWRCB approved the transfer under a series of Water Code provisions – none of which are part of the Irrigation District Act – does not mean that the IID can ignore its responsibilities and obligations under other laws. For example, IID continues to post notice of its public meetings that address the transfer. That notice requirement is not contained in the SWRCB decision. Instead, IID understands that it remains bound by the Brown Act that mandates public posting of certain meetings. IID does not apply its faulty logic to take the position that because the SWRCB decision does not specifically require posting of meeting notices, it is now relieved of that responsibility. To put it simply, the SWRCB decision is limited and did not address, much less alter, the relationship between IID and its beneficiaries. The very Water Code provision upon which IID relies in its response memo illustrates that there is no basis to contend the SWRCB absolved IID of its trust duties attendant to the water rights. "Nothing in this article does any of the following . . . . (d) Makes any change in existing water rights." Water Code § 1745.09(d). (Bottom of page 6 of IID memo).

The IID response memo pointed out that no water right was being transferred, only "conserved water." (Point 5, pages 6-7 of IID memo). But that is a distinction without a difference. Just like any other asset, conserved water is either (1) held in trust by IID for trust use (the traditional view) and any payment for the transfer of the water is a proportional asset of all beneficiaries or (2) the conserved water is an individual asset that the individual landowners can then transfer to IID for ultimate transfer out of the district boundaries. Since IID has obtained no change of its trust authority, we conclude that the conserved water must as a matter of law be classified as (1), a trust

asset. Under Water Code section 22437, "all property acquired by a district" is held for trust use, not just water rights. IID's emphatic point that individuals cannot independently transfer conserved water out of the district under the various Water Code provisions supports the view that IID treats conserved water as a district (i.e., trust) asset rather than an individual one.

IID's proposed plan, however, is to contract with individual landowners to acquire their conserved water for transfer. The stumbling block is that once acquired by IID, the conserved water becomes a trust asset and it cannot then as a matter of law pay any value for the transfer to that individual landowner, but rather to all beneficiaries proportionately. In other words, a sign up system premised on paying an individual to conserve is inconsistent with IID's organic authority. Instead, the only option available to IID is to create the conserved water on a district basis and transfer it on a district basis – using the intra district water bank, for example. It cannot be emphasized enough that an irrigation district is not a simple series of individuals who have given an irrevocable collective power of attorney to the district board over their water rights, but are beneficiaries of a trust and must be treated as such. Thus, we conclude that because IID continues to ignore the very authority under which it functions (both the water Code and the Probate Code), its proposals – no matter how well intended – create more problems than they can hope to solve.